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Supreme Court of the United States

OCTOBER TERM, 1977.

No. 77-454

MOORMAN MANUFACTURING COMPANY,
Appellant,

vs.

G. D. BAIR, DIRECTOR OF REVENUE,
Appellee.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF IOWA.

BRIEF AMICI CURIAE OF IOWA MANUFACTURERS ASSOCIATION, DEERE & CO., E. I. DuPONT DeNEMOURS & COMPANY, THE MAYTAG COMPANY, MONSANTO COMPANY, AND STANDARD BRANDS INCORPORATED.

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OPINIONS BELOW.

The opinions and judgment from which this appeal is taken are reported at 254 N. W. 2d 737 (Iowa 1977), and are reproduced in the Appendix at A-103. The opinion of the Iowa Director of Revenue may be found in the Appendix at A-2. The opinions of the Iowa District Court for Polk County are unreported and are to be found in the Appendix at A-56.

JURISDICTION.

This Court's jurisdiction is invoked pursuant to 28 U. S. C. § 1257(2).

CONSENTS OF PARTIES.

Both parties have consented in writing to the filing of this brief *amici curiae* and their letters of consent have been filed with the Clerk of the Court.

INTERESTS OF AMICI CURIAE.

The Iowa Manufacturers Association, organized in 1903, has a membership of 680 manufacturers of both Iowa and non-Iowa origins. The individual corporate *amici* are all heavily engaged in interstate commerce, do substantial business in Iowa, and are subject to the Iowa income tax that is the object of attack in this law suit. All of the members of the Association and the individual corporations would be seriously affected by a decision that the Iowa income tax law was invalid on its face, but are not likely to be affected by any decision on the question whether the statute was invalidly aplied to the Appellant here.

CONSTITUTIONAL AND STATUTORY PROVISIONS.

Article I, § 8, cl. 3 of the Constitution provides:

> The Congress shall have Power . . .To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;

Amendment XIV, § 1 of the Constitution provides:

> . . . No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United State; nor shall any State deprive any person of life, liberty, or property, without due proces of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Sections 422.33 and 422.35 of the Code of Iowa are set out in the Appendix at A-1 to A-5.

QUESTION PRESENTED.

Does the Iowa income tax, with its apportionment formula based on ratio of Iowa sales to total sales, fall afoul the Commerce Clause or the Fourteenth Amendment's Due Process or Equal Protection Clauses, in the absence of any evidence that the formula effected a "grossly distorted result" as applied to the Appellant?

STATEMENT.

In view of the full statement of facts in the brief for the Appellee, we limit our statement to three matters of critical importance to the Court's disposition of this case.

First, it is patently false to suggest that the State of Iowa is seeking to tax the Moorman Manufacturing Company ("Moorman") on "100% of its income." Notwithstanding statements to this effect in appellant's brief, the fact is that in none of the tax years at issue did Iowa seek to impose a tax on more than 21.9% of Moorman's apportionable income. (Exh. 1-A, App. 34.) Furthermore, if one looks at the overall tax burden imposed by the State of Iowa upon Moorman in light of its total income, the percentages are even smaller. In none of the tax years at issue did Iowa seek to tax Moorman on more than 17% of its federal taxable income. (Exh. 1-A, App. 4.)[1]

Second, the focus of the controversy before this Court is Moorman's apportionable income, *i.e.*, that portion of Moorman's federal taxable income which must be apportioned in part to Iowa pursuant to an appropriate formula because its precise geographical source cannot be satisfactorily identified. Indeed, the most salient fact in this case may well be the complete absence in the record of any evidence indicating precisely where Moorman's income was actually earned. It is because one cannot on this record identify the sources of Moorman's earnings

1. The percentages were calculated by adding Moorman's assignable income to Moorman's income apportionable to Iowa and dividing by Moorman's Federal taxable income. In fact, the percentage figures in the text overstate the extent of Moorman's Iowa tax liability since only a small portion of Moorman's assignable income—dividends, interest, and the like—were actually assignable to Iowa. *See* Moorman's Income Tax Returns for 1968-1972. These returns are in the Record but were not included as part of the Appendix, and the calculations were therefore made on the basis of figures readily available to the Court.

— the profits it may have gained through operations in one State, the losses it may have suffered through operations in another — that resort to an apportionment formula is necessary to provide a rough approximation of the source of those earnings. Choice of a particular formula is merely a means of establishing that source for tax purposes.

Third, the stipulated facts of this case raise the question whether the Commerce Clause may be relied upon at all as a basis for invalidating the Iowa tax as applied to Moorman. The activities on which the tax was based were solely intrastate activities. According to the stipulated facts, Moorman's products were manufactured in Illinois and shipped to Moorman's warehouses in Iowa. (App. 24.) Sales in Iowa were made by Iowa salesmen and warehousemen from Moorman's Iowa warehouses to Iowa consumers. (App. 24.) These are not interstate sales. There is no interstate commerce affected by imposition of this tax. The fact that Moorman is a foreign corporation does not translate the tax into a burden on interstate commerce. The fact that, before the goods came to rest in Iowa warehouses, they made the journey from Illinois, does not make the Iowa sales into sales in interstate commerce. Hence, so far as Moorman is concerned, the tax in question here may be regarded as a tax on intrastate commerce only, with the measure of the tax a proportionate share of its net income.

SUMMARY OF ARGUMENT.

In the long history of constitutional litigation over the validity of formulas designed to apportion a just share of a multistate business's property or income to a taxing State, this Court has never held an apportionment formula unconstitutional on its face. And in those few instances in which the Court, after searching inquiry, has held the application of an apportionment formula to a particular taxpayer unconstitutional, it has done so only on the basis of an overwhelming evidentiary showing by the taxpayer that the formula in question actually produced a grossly distorted result. The Court's traditional reluctance to tamper with State apportionment formulas is not an historical accident. Rather it stems from fundamental principles to which the Court has consistently adhered. These principles lie at the heart of our federal system as they involve a proper respect for State taxing power as well as an appreciation of the appropriate role of the judiciary in keeping that power within constitutional bounds. Unless this Court is to ignore these principles and in effect abandon a century of precedent, the exercise of Iowa's tax power in this case must be sustained.

In evaluating the contention under the Due Process Clause that an apportionment formula attributes more property or income to a taxing State than it may rightly claim, this Court has invariably emphasized two points. First, the Court has recognized that the very nature of the undertaking—the resort to a mathematical formula to determine the State's share of a business entity's tax base where there is no satisfactory way of determining it directly—involves rough approximation. The Court has repeatedly held that the Due Process Clause requires nothing more exacting. Second, and following naturally from the first point, the Court has made it plain that a taxpayer challenging an apportionment formula has more than the usual heavy burden

of proving by clear and convincing evidence that the application to it of the formula produces a grossly disproportionate result. This is never accomplished by hypothetical examples or merely showing the possibility of unfairness. Rather it can be demonstrated only by a powerful evidentiary showing that as applied to a particular taxpayer the operation of the formula is palpably unfair. A faithful implementation of these principles requires, as the Supreme Court of Iowa held, that the State's apportionment formula be sustained as constitutional on its face. These principles likewise support the determination, which the Supreme Court of Iowa made,[2] that the record in this case wholly fails to establish the gross deviation from a reasonable apportionment that is necessary to invalidate an apportionment formula as applied to a particular taxpayer.

Even if it is assumed that interstate commerce is involved in this case,[3] the criteria for evaluating the constitutionality of the apportionment formula under the Commerce Clause do not differ in substance from those under the Due Process Clause, as this Court has stated on a number of occasions. And for essentially the same reasons, settled constitutional doctrine requires, as the Supreme Court of Iowa held, that the Iowa apportionment formula be sustained on its face and as applied under the Commerce Clause. Indeed, this Court has upheld, over both Commerce Clause and Due Process Clause objections, much more sweeping exercises of State tax power than are even alleged in this case. For the Court to hold the exercise of such power unconstitutional in this case would amount to

2. 254 N. W. 2d at 753-54 (A-137-A-139). In light of the great reliance placed by Appellant on the so-called "findings" of the Iowa district court, it should be noted that review in the Iowa Supreme Court in equity actions, such as the instant case, is *de novo*. Iowa Const., Art. V, § 4; Iowa Code, § 422.29, § 686.2; Rule of Civil Procedure 334, repealed 1 July 1977, after the close of this litigation, and replaced by Rule of Appellate Procedure 4. Thus, it is the findings of the Iowa Supreme Court, not those of the inferior tribunal, that are controlling for purposes of this appeal.

3. The sales on which the tax is based were all made from goods in Appellant's warehouse to Iowa purchasers. See p. 5, *supra*.

the effective overruling of a large number of its precedents—some of them of recent vintage—and would constitute a wholesale and unwarranted uprooting of the framework which for years has been the basis of adjudication of the constitutional limitations on the exercise of State tax power.

The challenge to the Iowa apportionment formula on Equal Protection grounds is plainly insubstantial. The States are accorded the utmost leeway in making classifications for tax purposes, as recent decisions of this Court demonstrate. Hence, even accepting Moorman's suggestions that the legislature has made the classifications of which it complains, they are unobjectionable from a constitutional standpoint.

Moorman's case rests primarily on dicta drawn from this Court's opinion in *General Motors Corp.* v. *District of Columbia*, 380 U. S. 553 (1965), which invalidated the District of Columbia's single-factor apportionment formula. But that decision provides only superficial support for Moorman's position here, since the Court explicitly refrained from reaching the constitutional issues sought to be raised in that case. The decision, therefore, cannot be invoked to justify a holding that an apportionment formula is unconstitutional on its face in the teeth of controlling constitutional precedent to the contrary. Nor does it provide any support for a finding that the statute is unconstitutional in its application to the taxpayer here in light of the insufficiency of this record to sustain such a finding.

As this Court has many times acknowledged, it has neither the constitutional power nor institutional capability to play anything but a limited role in reviewing the propriety of formulas designed to apportion a share of a multi-state enterprise's tax base to the taxing State. Other than taking the extraordinary step of invalidating the application of a formula in that rare case when a taxpayer has been able to demonstrate by clear and cogent evidence that the formula has a produced a grossly distorted result—evidence of which this record is totally barren—the Court has accordingly refrained from interfering with the

application of State apportionment formulas. It has done so in the recognition that—absent congressional legislation imposing a uniform formula—variations in such formulas are to be expected and, from a constitutional standpoint, must be tolerated. For this Court to hold that the Iowa apportionment formula is unconstitutional because it varies in some respects from formulas currently in vogue in other States would be in effect to impose upon all States the requirement of adopting a particular formula to apportion corporate income. Such a step would be wholly inconsistent with this Court's constitutional tradition and would arrogate to itself the power to act affirmatively under the Commerce Clause—a power that is confided solely to Congress by the Constitution. In light of Congress' failure to act in this area, despite repeated consideration as to whether it should do so, it would be especially unseemly for this Court to take the unprecedented step of effectively imposing a uniform apportionment formula upon the States, even if such action were within the scope of its constitutional power.

ARGUMENT.

I.

THE STATUTORY REQUIREMENT THAT NET INCOME BE APPORTIONED TO IOWA BY THE RATIO OF IOWA SALES TO TOTAL SALES IS CONSTITUTIONAL ON ITS FACE UNDER THE DUE PROCESS CLAUSE AND THE COMMERCE CLAUSE.

Moorman has challenged the constitutionality of the apportionment provision of the Iowa corporate income tax under both the Due Process Clause and the Commerce Clause. It must be recognized that there is considerable overlap in the constitutional analyses under these Clauses. Indeed, as this Court recently remarked in the context of a constitutional challenge to a State apportionment formula on both Due Process and Commerce Clause grounds:

> "The problem under the Commerce Clause is to determine 'what portion of an interstate organism may appropriately be attributed to each of the various states in which it functions.' *Nashville, C. & St. L. R. Co.* v. *Browning*, 310 U. S. 362, 365. So far as due process is concerned the only question is whether the tax in practical operation has relation to opportunities, benefits, or protection conferred or afforded by the taxing State. See *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435, 444. Those requirements are satisfied if the tax is fairly apportioned to the commerce carried on within the State." *Ott* v. *Mississippi Valley Barge Line Co.*, 336 U. S. 169, 174 (1949). Neither appellants nor appellees contend that these two analyses bear different implications insofar as our present case is concerned. [*Norfolk & Western Ry.* v. *State Tax Commission*, 390 U. S. 317, 325 n. 5 (1968).]

Although the Due Process Clause and Commerce Clause challenges to the constitutionality of the statute are addressed separately here, much of what will be said under the rubric of Due Process is equally applicable to the Commerce Clause. To avoid repetition, discussion of the Commerce Clause will be limited to any additional constitutional limitations arguably imposed by that Clause on the State's power to apportion net income.

A. The Iowa Formula for Apportioning Net Income to the State Is Constitutional on Its Face under the Due Process Clause.

The Due Process Clause standards for evaluating an apportionment formula are largely shaped by the underlying reason for using such a formula in the first place. Where an enterprise carries on a single integrated business both within and without the State, its tax base generally cannot satisfactorily be identified or segregated on a geographical basis. See ALTMAN & KEESLING, ALLOCATION OF INCOME IN STATE TAXATION 107 (2 ed. 1950). Due to the impracticability of so identifying or segregating the tax base of such an enterprise—referred to as a "unitary business"—resort is made to apportionment formulas as a rough means of attributing a reasonable share of the tax base to the taxing State. These considerations are especially pertinent to the taxation of net income, which is at issue here. For, as the Court has observed, the net income or profits of a business frequently are "earned by a series of transactions beginning with manufacture in [one state] and ending with sale in other States" and "[t]he legislature, in attempting to put upon this business its fair share of the burden of taxation [is] faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113, 120-21 (1920).[1]

1. The Iowa apportionment provisions faithfully reflect these principles. The statute defines a "Unitary business" as a "business carried on partly within and partly without a state where the portion of the business carried on within the state depends on or contributes to the business outside the state." Iowa Code § 422.32(6). Only a

(Footnote continued on next page.)

It is in view of the underlying rationale for applying an apportionment formula to a multistate enterprise's overall tax base that the governing constitutional principles become clear and comprehensible. Ever since this Court approved the use of a rail mileage formula as a "just and equitable method" of ascertaining the proportion of a corporation's property taxable by a State, *Pullman's Palace Car Co.* v. *Pennsylvania,* 141 U. S. 18, 26 (1891), it has recognized that such formulas, which owe their very existence to the absence of exact alternatives for dividing the tax base of a unitary business, cannot be expected to achieve precision.

> [T]his Court has long realized the practical impossibility of a state's achieving a perfect apportionment of expansive, complex business activities . . . and has declared that "rough approximation rather than precision is sufficient." *Illinois Central Ry.* v. *Minnesota,* 309 U. S. 157, 161. [*International Harvester Co.* v. *Evatt,* 329 U. S. 416, 422 (1947).]

Time and again this Court has emphasized that "by its very nature the problem is incapable of precise and arithmetical solution," and that "exactness is concededly unobtainable." *Nashville, C. & St. L. R. Co.* v. *Browning,* 310 U. S. 362, 365-66 (1940). As a logical corollary, the Court has therefore refused to upset the application of State apportionment formulas without a showing by the taxpayer that the apportionment is in fact "out of all appropriate proportion to the business transacted," *Hans Rees' Sons, Inc.* v. *North Carolina* ex rel. *Maxwell,* 283 U. S. 123, 135 (1931), or produces a "grossly distorted result." *Norfolk & Western Ry.* v. *State Tax Comm'n,* 390 U. S. 317, 326 (1968).

In light of the constitutional criteria for evaluating apportionment formulas, it is apparent why the Court has never held

(Footnote continued from preceding page.)
corporation carrying on such a unitary business in Iowa is required to determine its net income attributable to the State by an apportionment formula, and the regulations refer to Supreme Court authority for guidance in determining whether a business is unitary. See Iowa Admin. Code § 730-54.8 (422), referring to *Butler Bros.* v. *McColgan,* 315 U. S. 501 (1942).

such a formula unconstitutional on its face and why there is no basis for doing so in this case. To hold that an apportionment formula is unconstitutional "on its face," as Moorman urges the Court to do here (Appellant's Br. 21), is to make the judgment that such a formula by its very terms will necessarily produce a "grossly distorted result" or an apportionment "out of all proportion to the business transacted." But how can one make the judgment that a formula will necessarily produce an apportionment "out of all proportion to the business transacted" without actually examining the business transacted and comparing it with the result produced? The answer is that as a matter of constitutional law one cannot make such a judgment—at least with respect to the type of apportionment formulas this Court has heretofore considered and sustained which includes the very formula at issue here.[2] For if there is any single principle that emerges from this Court's numerous decisions regarding State apportionment formulas, it is that due regard for State taxing power and recognition of the imprecision inherent in any attempt to apportion a unitary enterprise's tax base requires that the constitutionality of such formulas be evaluated as applied to the particular taxpayer.

Examination of the Court's decisions upholding apportionment formulas based on such factors as track mileage,[3] barge line mileage,[4] designated assets,[5] gross receipts,[6] property,[7] and payroll,[8] — all of which are by definition constitutional on their

2. See *Ford Motor Co.* v. *Beauchamp,* 308 U. S. 331 (1939).

3. See, *e.g., Pullman's Palace Car Co.* v. *Pennsylvania,* 141 U. S. 18 (1891).

4. See, *e.g., Ott* v. *Mississippi Barge Line Co.,* 336 U. S. 169 (1949).

5. See, *e.g., Bass, Ratcliff & Gretton* v. *State Tax Commission,* 266 U. S. 271 (1924).

6. See, *e.g., Ford Motor Co.* v. *Beauchamp,* 308 U. S. 331 (1939).

7. See, *e.g., Underwood Typewriter Co.* v. *Chamberlain,* 254 U. S. 113 (1920).

8. See, *e.g., Butler Bros.* v. *McColgan,* 315 U. S. 501 (1942).

face — reveals the consistency with which the Court has adhered to this principle. It is demonstrated even more strikingly in those rare instances in which the Court has found that the application of the particular formula exceeded constitutional bounds. Thus in the single case in the last forty years in which the Court has found the application of an apportionment formula unconstitutional, *Norfolk & Western Ry.* v. *State Tax Commission,* 390 U. S. 317 (1968), the Court could not have been more explicit in the limited nature of its holding. Noting that it was dealing with the "familiar mileage formula" whose application it has sustained in "various contexts," 390 U. S. at 320, 326[9] and that the taxpayer must bear the usual "heavy burden" in challenging the application of such a formula, *id.* at 326, the Court found that the taxpayers had carried the burden by demonstrating that the "application of the mileage formula led to a grossly distorted result," and that the State "made no effort to offset the convincing case that they have made." *Ibid.* At the same time, the Court reiterated that its "decisions recognize the practical difficulties involved and do not require any close correspondence between the result of computations using the mileage formula and the value of property actually located in the State. . ." *Id.* at 327. The Court's holding thus reaffirmed the essential point that the constitutionality of apportionment formulas cannot properly be evaluated "on their face" but must be considered in the context of their application to the particular taxpayer who is charged with the heavy evidentiary burden of demonstrating that the formula has led to a "grossly distorted result."

The impropriety of evaluating the constitutionality of an apportionment formula by reference to its terms alone is particularly egregious in connection with the apportionment of net income, as in the instant case. In dealing with the overall net income of a unitary business, a State is faced not merely with the practical problems of directly segregating the tax base on a geographical basis, as was the case in *Norfolk & Western* v. *State Tax Comm'n* with respect to the railroad's rolling stock, but often with the virtual "impossibility of allocating specifically the profits earned by the processes within its borders." *Underwood Typewriter Co.* v. *Chamberlain,* 254 U. S. 113, 121 (1920). When the net income to be apportioned is in essence the net income reported on a multistate business's federal tax return, as it is in this case (Exh. 1-A, App. 34), there is ordinarily no way of determining, at least on an *a priori basis,* in which State such net income is earned. Perhaps all of the net gain of an integrated enterprise like Moorman, which engaged in both the manufacture and sale of its products, is in fact derived exclusively from the exploitation of particularly favorable markets in certain States. Indeed, it might well be the case that if selling profit could be considered separately, the enterprise's net income would be higher than it would be when such activity is considered in conjunction with less efficient manufacturing activities that might have been operating at a loss. To be sure, it is precisely because one cannot examine these activities separately to ascertain the exact source of the profits that one employs an apportionment formula to begin with. But given the premise, to hold that a formula for apportioning net income is "facially unconstitutional" is to make a judgment that wherever the true sources of an enterprise's net income may lie, an attempt to establish them by the formula in question will necessarily produce a "grossly distorted result."

Such a conclusion is plainly untenable here. In the example suggested above, in which all the profits of an enterprise are attributable to the existence of the favorable market where the sales are made, it could hardly be contended that the apportionment of such net income on the basis of sales produces a "grossly distorted result." And, if that is true the statute cannot be un-

9. The statute in question, quoted at 390 U. S. 320-21 provided ". . . when any railroad shall extend beyond the limits of this state and into another state in which a tax is levied and paid on the rolling stock of such road, then the said commission shall assess, equalize and adjust only such proportion of the total value of all rolling stock of such railroad company as the number of miles of such road in this state bears to the total length of the road as owned or controlled by such company."

constitutional on its face because it will not necessarily produce such a result. Moreover, since the very premise underlying the use of a formula to apportion net income is that one does not in fact know where such income is actually earned, one simply cannot say on an *a priori* basis that in any case the result produced will not constitute a "rough approximation" of the actual source of the enterprise's earnings, which, as indicated above, is all the Constitution demands. This does not preclude a taxpayer from attempting to demonstrate by clear and cogent evidence that the apportionment formula as applied has in fact produced a "grossly distorted result" and is therefore unconstitutional. See pp. 22-37, *infra*. But to hold that an apportionment formula is unconstitutional as applied after such a showing has been made is very different from holding such a formula unconstitutional on its face, as is urged here.

Any conceivable doubt about the constitutionality of Iowa's apportionment formula on its face is laid to rest by controlling precedent. First, not a single decision of this Court can be cited for the proposition that a net income apportionment formula —or indeed any apportionment formula—is unconstitutional on its face, for the simple reason that this Court has never so held. The absence of any such holding is no historical accident. Rather, it stems from fundamental considerations relating to the proper respect for State taxing power and the conceded impossibility of achieving precise results. See, *e.g.*, *Nashville, C. & St. L. R. Co.* v. *Browning*, 310 U. S. 362, 365-66 (1940).

Second, in those cases where the Court has considered the application of apportionment formulas to the net income of particular taxpayers, it has made it clear that the Constitution does not limit the States with respect to the type of formula they may employ to apportion net income. Thus, the Court has upheld formulas for apportioning net income based on the ratio of a taxpayer's in-state property to its property wherever located, *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113 (1920); *Kent-Coffey Mfg. Co.* v. *Maxwell*, 291 U. S. 642

(1934), *aff'g per curiam* 204 N. C. 365, 168 S. E. 397 (1933); and of a taxpayer's designated in-state assets to such assets wherever located, *Bass, Ratcliff & Gretton* v. *State Tax Commission*, 266 U. S. 271 (1931); and of a taxpayer's in-state property, payroll, and sales to such property, payroll, and sales wherever located. *Butler Bros.* v. *McColgan*, 315 U. S. 501 (1942). Inasmuch as these formulas for apportioning net income have thus been held constitutional on their face (as well as in application), one can hardly conclude that the Constitution requires the States to apportion net income pursuant to any particular formula or to include a specified type or number of factors in the formula. Indeed, on the one occasion that the Court did find that the application of an apportionment formula to a taxpayer's net income[10] produced a result "out of all appropriate proportion to the business transacted" by the taxpayer in the state, *Hans Rees' Sons* v. *North Carolina* ex rel. *Maxwell*, 283 U. S. 123, 135 (1931), the apportionment was made under the very formula which the Court had upheld previously, see *Underwood Typewriter Co.* v. *Chamberlain, supra*, and would uphold again, see *Kent-Coffey Mfg. Co.* v. *Maxwell, supra*. Thus it is plainly in their application—and never by their terms alone —that the constitutionality of apportionment formulas must be evaluated.

Finally, one cannot ignore the Supreme Court's decision in *Ford Motor Co.* v. *Beauchamp*, 308 U. S. 331 (1939). The Court there sustained on its face and as applied the very apportionment formula at issue here, one based on the ratio of gross receipts from business done in the state to gross receipts from the entire business. While the formula was employed to apportion the taxpayer's capital stock, surplus, undivided profits, and long-term obligations,[11] rather than its net income, there is

10. *Norfolk & Western* v. *State Tax Comm'n* was not concerned with a net income tax.

11. The tax at issue was "based upon that proportion of the outstanding capital stock, surplus and undivided profits, plus the

(Footnote continued on next page.)

nothing in the case to suggest that the Court's holding—sustaining the constitutionality of an apportionment formula based on gross receipts—would be inapplicable to a tax upon net income. Notwithstanding Moorman's suggestion that the case is "irrelevant" because it does not deal with a net income tax (Appellant's Br. 24), the Court's opinion suggests quite the opposite. It explicitly relies on cases involving the taxation of net income in upholding the levy at issue, see 308 U. S. at 335 (citing *Underwood Typewriter Co.* v. *Chamberlain, supra,* and *Bass, Ratcliff & Gretton* v. *State Tax Commission, supra*). Moreover, its language suggests that to restrict the decision's import to the particular type of tax or formula there involved would be to take an impermissibly crabbed approach to the scope of State tax power. Hence it rejected the taxpayer's contention that "the constitutionality of state taxation turns on so narrow an issue as whether local assets rather than local gross receipts are used in a taxing formula." *Id.* at 336.

B. The Iowa Formula for Apportioning Net Income to the State Is Constitutional on Its Face under the Commerce Clause.

As indicated above (see pp. 10-11, *supra*), many of the considerations that were discussed under the rubric of Due Process are equally applicable to an evaluation of the constitutionality of an apportionment formula under the Commerce Clause. Indeed, in many of the cases cited in the preceding discussion, the taxpayer attacked the constitutionality of the formula on both Due Process and Commerce Clause grounds and the Court dealt with both contentions, often without distinguishing between the two. See *Underwood Typewriter Co.* v. *Chamberlain,* 254 U. S. 113 (1920); *Bass, Ratcliff & Gretton* v.

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amount of outstanding bonds, notes and debentures, other than those maturing in less than a year from date of issue, as the gross receipts from its business done in Texas bears to the total gross receipts of the corporation from its entire business." 308 U. S. at 332-33.

State Tax Commission, 266 U. S. 271 (1924); *Ford Motor Co.* v. *Beauchamp,* 308 U. S. 331 (1939); *Nashville C. & St. L. R. Co.* v. *Browning,* 310 U. S. 362 (1940); *International Harvester Co.* v. *Evatt,* 329 U. S. 416 (1947); *Ott* v. *Mississippi Barge Line Co.,* 336 U. S. 169 (1949); *Norfolk & Western Ry.* v. *State Tax Commission,* 390 U. S. 317 (1968). Although the verbal formulation of the issue under the two Clauses may differ, the substantive inquiry is essentially the same. If the application of an apportionment formula results in the taxation of property or income with which the State has no connection in violation of the Due Process Clause, it will likely impose a burden upon or result in the multiple taxation of interstate commerce in violation of the Commerce Clause.[12] And if the taxing power of the State is exercised through the use of an apportionment formula within the broad limits defined by the Due Process Clause, it is unlikely to offend the requirements of the Commerce Clause.

The traditional invulnerability of State apportionment formulas to attacks on their "facial" constitutionality embraces both Commerce and Due Process Clause challenges, as the cases cited in the preceding paragraph demonstrate. To conclude that the Iowa apportionment formula violates the Commerce Clause on its face, one would have to determine that the net income apportioned to Iowa under the formula will necessarily produce a "grossly distorted result," thus burdening interstate commerce or subjecting it to multiple taxation. But, as explained above (see pp. 11-13, *supra*), the very reason one apportions the net income of a unitary business like Moorman's is that no one knows precisely where it was earned. To conclude that the sales-factor formula is unconstitutional on its face is to conclude that the profits apportioned to the taxing State by the formula could not in fact have been earned there. Such a conclusion is plainly

12. As the Court put it in *Norfolk & Western Ry.* v. *State Tax Commission,* 390 U. S. at 325: "The taxation of property not located in the taxing State is constitutionally invalid, both because it imposes an illegitimate restraint on interstate commerce and because it denies to the taxpayer the process that is his due."

untenable, for reasons already explained which need not be repeated here. (See pp. 14-16, *supra.*) It is sufficient for present purposes to note that "rough approximation rather than precision," is the constitutional criterion for judging the validity of apportionment formulas under the Commerce Clause as well as the Due Process Clause, see *Illinois Central R. R.* v. *Minnesota,* 309 U. S. 157, 161 (1940); *Nashville, C. & St. L. R. Co.* v. *Browning,* 310 U. S. 362, 365-66 (1940), and there is no basis for invalidating the Iowa apportionment formula as unconstitutional on its face under the Commerce Clause.

C. The Court's Opinion in General Motors Corp. v. District of Columbia, 380 U. S. 553 (1965), Does Not Control Resolution of the Constitutional Issues Raised by this Appeal.

The foregoing analysis is essentially unaffected by *General Motors Corp.* v. *District of Columbia,* 380 U. S. 553 (1965), on which Moorman principally relies. *General Motors* involved the District of Columbia franchise tax, which was measured by net income. In contrast to the provision of the Iowa statute here at issue which reflects a deliberate legislative judgment as to the appropriate method of apportionment, the District of Columbia tax statute left the question of apportionment methods to the discretion of the tax commissioners. That discretion, however, was limited by the statutory directives that "[t]he measure of the franchise tax shall be that portion of the net income of the corporation . . . as is fairly attributable to any trade or business carried on or engaged in within the District . . . ," and that "[i]f the trade or business of any corporation . . . is carried on or engaged in both within and without the District, the net income derived therefrom shall . . . be deemed to be income from sources within and and without the District." 380 U. S. at 554-55. The commissioners promulgated regulations that apportioned the income of certain corporations, which included General Motors, to the District by the percentage that "District

sales made during the taxable year bear to the total sales made everywhere during such taxable year." *Id.* at 555.

General Motors made substantial sales in the District but carried on no manufacturing operations there. It challenged the commissioners' apportionment regulations on the grounds that the apportionment of its income to the District solely on the basis of a sales factor was inconsistent with the statute as well as the Due Process and Commerce Clauses. Refusing to address the constitutional issues, this Court held that the regulations providing for apportionment by a single-factor sales formula were not authorized by the statute. The Court read the statute to require not only that the income of a corporation doing business within and without the District be apportioned, as the United States Court of Appeals had held, but to require in addition the apportionment of that particular portion of a corporation's income earned from manufacture outside and sales inside the District.

For a number of reasons, the *General Motors* decision is of limited significance here. First and foremost, the Court's decision was not based on constitutional grounds. The Court could not have been more explicit on this point, noting that it did not take "any position on the constitutionality of a state income tax based on the sales factor alone," and that it had "refrained from attempting to define any single appropriate method of apportionment." 380 U. S. at 561. Thus, the case simply does not stand for the proposition that the apportionment formula there at issue —let alone the formula at issue in this case— is unconstitutional on its face. Secondly, the statutory language on which decision turned in *General Motors* was not the provision making "net income . . . as is fairly attributable" to the District taxable; rather it was the specific requirement that net income derived from a trade or business carried on within and without the District shall "be deemed to be income from sources within and without the District." It was the Court's interpretation of this statutory phrase—which has no analogue in the Iowa statute

and can scarcely be found in the Due Process or Commerce Clauses—which was the fulcrum of the Court decision. Third, while the Court in dicta expressed some concern that the Districts' formula was not consistent with those generally prevailing in other jurisdictions, these general observations made in support of its reading of the District of Columbia statute simply cannot be translated into constitutional imperatives in light of the specific disavowal by the Court of any intention of reaching the constitutional questions potentially raised. Finally, even reading *General Motors* as a constitutional opinion would not lend support to Moorman's contention here that the Iowa statute is unconstitutional on its face. In light of the evidentiary showing made by General Motors and the findings of the trial court there, the decision would stand for no more than the established principle that when an apportionment formula produces a "grossly distorted result," it may be struck down as unconstitutional in its application to a particular taxpayer.

II.

THE STATUTORY REQUIREMENT THAT NET INCOME BE APPORTIONED TO IOWA BY THE RATIO OF IOWA SALES TO TOTAL SALES IS CONSTITUTIONAL AS APPLIED TO MOORMAN UNDER THE DUE PROCESS CLAUSE AND THE COMMERCE CLAUSE.

In addition to alleging that the Iowa apportionment formula is unconstitutional on its face, Moorman contends that the formula is unconstitutional in its application to Moorman. The Iowa Supreme Court, which reviewed the evidence *de novo*,[1] found that Moorman had failed to carry its evidentiary burden of establishing that the formula in its application to Moorman was either unreasonable or arbitrary.[2] The Iowa Supreme Court's

1. See page 7, note 2, *supra*.

2. 254 N. W. 2d at 753-54 (App. 137-39). In this connection two points should be kept in mind. First, the trial court never reached the issue of the constitutionality of the Iowa apportionment

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determination was required by the governing constitutional precedents and should be sustained by this Court.

A. The Iowa Formula for Apportioning Net Income to the State Is Constitutional as Applied to Moorman under the Due Process Clause.

The fundamental issue in any constitutional challenge to the application of a State apportionment formula is whether the taxpayer has met the extraordinary burden of showing by "clear and cogent evidence" that the apportionment produces a "grossly distorted result" or one "out of all appropriate proportion to the business' transacted by the taxpayer in the State. See *Norfolk & Western Ry.* v. *North Carolina* ex rel. *Maxwell*, 297 U. S. 682, 688 (1936); *Norfolk & Western Ry.* v. *State Tax Commission*, 390 U. S. 317, 329 (1968); *Hans Rees Sons, Inc.* v. *North Carolina* ex rel. *Maxwell*, 283 U. S. 123, 135 (1931). Time and again this Court has reiterated that the constitutional standards are not unduly exacting, see, *e.g.*, *Butler Bros.* v. *McColgan*, 315 U. S. 501, 506 (1942), as indeed they cannot be in an area where "exactness is concededly unobtainable." *Nashville, C. & St. L. R. Co.* v. *Browning*, 310 U. S. 362, 365-66 (1940). These controlling principles, which have been given concrete expression on numerous occasions, fully support the Iowa Supreme Court's determination that Moorman has failed to carry its heavy burden to prove that the application to Moorman of the State's apportionment formula is unconstitutional.

Moorman is a nationwide enterprise engaged in the manufacture and sale of livestock and poultry feed products. Its sales

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formula in its application to Moorman, because it had resolved the issues before it in terms of the facial constitutionality of the statute. (App. 56-98.) Thus we have no factual findings of the Iowa trial court with respect to this issue. Second, it is clear, in any event, that no reliance may be placed on the findings of the district court—in whatever context made—since in equity cases the Iowa Supreme Court exercises *de novo* review and thus its findings, rather than those of the trial court, are controlling on this appeal. See page 7, note 2, *supra*.

activities span more than thirty States, including Iowa, where it makes substantial sales. The products sold in Iowa are manufactured in Illinois. Moorman's argument that the Iowa apportionment formula is unconstitutional as applied rests essentially on the allegation that the Iowa formula compels a foreign producer like Moorman to "pay tax on 100% of [its] income from Iowa business already heavily, and properly, taxed in other states." (Appellant's Br. 20.) To support this assertion, Moorman relies ultimately on the findings of the Iowa district court that, as Moorman puts it, "[t]he Iowa single-factor formula taxed 100% of the income from each dollar of sales of Moorman's goods into Iowa, although 75% of payroll and 30% of capital are used in the manufacture of goods (in Illinois) . . . and resulted in 'gross overreaching' by the State." *Id.* at 5. As indicated above, the relevance of the Iowa district court's findings for purposes of this appeal is highly questionable. See page 7, note 2, *supra*. Nevertheless, assuming *arguendo* that such findings (and Moorman's contentions based on them) may be considered by this Court, it is plain that they cannot withstand analysis.

Under the Iowa corporate income tax statute, it is indisputable that the only "income" of a taxpayer like Moorman that is ever subject to apportionment is a specified portion of such taxpayer's federal taxable income.[3] Thus, the single-factor sales formula, which is employed to apportion a fair share of Moorman's income to Iowa, is applied neither to Moorman's gross income, nor to the income that Moorman may have earned in its operations in Illinois and Iowa. Rather, it is applied directly to a portion of Moorman's overall federal taxable income and thus represents an attempt to apportion to Iowa a share of Moorman's overall net income or profits attributable to Iowa operations.

In light of the way the Iowa apportionment scheme actually operates, the fundamental misconception underlying appellant's

3. See Iowa Code §§ 422.33, 422.35 (reproduced in Appellant's Br., App. B, A1-A5); Exh. 1-A (App. 34).

reasoning becomes apparent. As noted above, Moorman relies on the trial court's finding that "because the Iowa single sales factor tax admits of neither property nor payroll inputs in Illinois plant and labor as part of its formula, each dollar of sales of Moorman's goods in Iowa is taxed at 100% while nearly 75% of Moorman's payroll and 30% of its capital is used in the manufacture of goods taxed here." App. 76; Appellant's Br. 5. This assumes that the net income actually taxed by Iowa can be directly correlated with the sales, property, or payroll that may be factors in the formula designed to apportion such income. But such an assumption flies in the face of the facts. Each "dollar in sales of Moorman's goods in Iowa" is not taxed at all—contrary to Moorman's statement. Rather, each dollar in sales is used simply to apportion a small fraction of Moorman's net income to Iowa.[4] Whether in fact that particular sales dollar produced more or less net income from Moorman in Iowa than is apportioned pursuant to the formula is something that we simply do not know—at least not on this record. For there is nothing in the record which shows the precise source of any of Moorman's net income. Rather, as in *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113 (1920), the "profits of the corporation were largely earned by a series of transactions beginning with manufacture in [one State] and ending with sale in other States" with the consequent "impossibility of allocating specifically the profits earned by the processes conducted" within one State's borders. *Id.* at 120-21.

Nevertheless, Moorman argues that the Iowa formula "fails to allow a reasonable apportionment of income associated with Iowa sales to be attributed to Illinois. . . ." (Appellant's Br. 30.) But in light of the impossibility—at least on this record—of identifying the precise sources of that portion of Moorman's overall federal net income to which the Iowa apportionment formula is actually applied, one cannot reasonably conclude that the single-factor sales formula fails fairly to apportion

4. Moorman's gross sales for the years in question averaged over $100,000,000. See Exh. 1-C (App. 36).

Moorman's net income. Merely because capital and labor outside Iowa have produced the product sold inside Iowa does not imply that any of the net income or profits from the ultimate sale are attributable to the manufacturing activities. For all that appears in the record, it could well be the case that it was only as a result of a highly favorable Iowa market that any net income was obtained at all from sales of Illinois-produced products. Thus, the attribution of Moorman's net income to Iowa on the basis of its sales-factor formula could actually underrepresent the profit attributable to Iowa, since it would not take into account the Illinois losses that had been offset by the Iowa gains before any net profits were even realized. This is not to argue that such was in fact the case. The point is simply this: the record does not reveal the precise sources of Moorman's overall net income, which could be attributable in whole or in part to its operations in any of over thirty states; that the Iowa apportionment formula was applied only to such overall net income, not gross sales; and that it is therefore impossible to say with any degree of confidence—and certainly not with that degree of confidence necessary to sustain a Due Process objection—that the net income apportioned pursuant to the Iowa formula was not fairly attributable to activities carried on by Moorman in Iowa.

This conclusion is reinforced by an examination of the decisions of this Court that have considered this problem. The Court has decided six cases involving challenges to the apportionment of a multistate enterprise's net income. The first was *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113 (1920). Underwood, like Moorman, manufactured and sold tangible personal property, with its activities spread out over a number of states. The State of Connecticut in that instance, like the State of Iowa here, sought to tax Underwood on a share of its net income attributable to its Connecticut operations. The net income in that case, like the net income here, was ascertained by reference to the corporation's federal taxable income. The Connecticut

formula which was applied to such net income to apportion a share to the State, like the Iowa formula here at issue, was based on a single ratio. The ratio employed was real and tangible personal property in the State to such property wherever located, which produced a Connecticut percentage of 47 percent. Underwood challenged the application of the apportionment formula to it on both Due Process and Commerce Clause grounds, arguing that since only about 3 percent of its profits were received from sales and other activities in Connecticut, it was improper to base the tax upon 47 percent of its entire net income. The Court rejected the contention in the language cited frequently in this brief:

> [Underwood's] showing wholly fails to sustain the objection. The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other States. In this it was typical of a large part of the manufacturing business conducted in the State. The legislature in attempting to put upon this business its fair share of the burden of taxation was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders. It, therefore, adopted a method of apportionment which, for all that appears in this record, reached, and was meant to reach, only the profits earned within the State. [254 U. S. 120-21.]

Four years after the *Underwood* decision, the Court again had occasion to consider a constitutional challenge to the apportionment of a tax based on net income in *Bass, Ratcliff & Gretton* v. *State Tax Commission*, 266 U. S. 271 (1924). The taxpayer was engaged in the brewing and sale of Bass' ale. All of the brewing was done in England, but it sold some of its products in New York, which sought to impose a tax upon a portion of the taxpayer's net income. As in *Underwood* and the instant case, the formula employed to apportion income to New York was based on a single factor, in this case the proportion of designated assets in New York to designated assets wherever located. As in *Underwood* and the instant case, the taxpayer

challenged the application of the formula to it on both Due Process Clause and Commerce Clause grounds, claiming, among other things, that because it had no federal net income—the net income to be apportioned was its world-wide income—New York must have been taxing income arising from business conducted outside the State. The Court, relying on its decision in *Underwood*, rejected the taxpayer's contentions in language that is relevant to the issue here:

> So in the present case we are of opinion that, as the Company carried on the unitary business of manufacturing and selling ale, in which its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places—the process of manufacturing resulting in no profits until it ends in sales—the State was justified in attributing to New York a just proportion of the profits earned by the Company from such unitary business. . . .
>
> It is not shown in the present case, any more than in the *Underwood* case, that this application of the statutory method of apportionment has produced an unreasonable result. The fact that the Company may not have had any net income upon which it was subject to payment of income tax to the Federal Government, obviously does not show that it received no net income from the business which it carried on in New York. There is no evidence in the record as to whether the Company received any net income from its New York business, or the amount of the profit and loss on that business, if any, either considered separately or in connection with the manufacturing business carried on in Great Britain. [266 U. S. at 282-83.]

The analogy to the instant case could hardly be closer—in light of Moorman's contention that the Iowa apportionment formula "fails to allow a reasonable apportionment of income associated with Iowa sales to be attributed to Illinois. . . ." (Appellant's Br. 30.) As in *Bass*, there is no evidence in the record as to whether the Company received any net income from its Illinois business or the amount of profit or loss on that business, if any,

either considered separately or in connection with the sales operations carried on in Iowa.

The next opportunity the Court had to consider a net income tax apportionment was in *Hans Rees' Sons, Inc.* v. *North Carolina* ex rel. *Maxwell*, 283 U. S. 123 (1931). As in the previous cases, the State sought to tax a portion of the overall net income of a manufacturer and seller of tangible personal property on the basis of a single-factor formula, here the ratio of real and tangible property located in North Carolina to such property wherever located. Again, the taxpayer challenged the application of the formula to its net income under the Due Process and Commerce Clauses. But there was a striking difference from the previous cases in the nature of the taxpayer's attack. In place of the generalized allegations and speculative observations concerning the purported source of the taxpayer's net income, the taxpayer produced clear and cogent evidence of the specific source of its profits—evidence which demonstrated that the apportionment formula in question that attributed "to North Carolina a percentage out of all appropriate proportion to the business transacted" by the taxpayer in the State. 283 U. S. at 135. Thus, the taxpayer specifically demonstrated that its profit was derived from buying profit, manufacturing profit, and selling profit; that the average income having its source in North Carolina on the basis of this evidence did not in any event exceed 21.7 percent, and was probably even lower; and that this was out of all proportion to the income apportioned pursuant to formula during the years in question which ranged from 66 to 85 percent.

The Court's language distinguishing its holding from the *Underwood* and *Bass* cases and reiterating the appropriate criteria for evaluating constitutional challenges to the application of State apportionment formulas as applied to net income is most instructive:

> Evidence which was found to be lacking in the *Underwood* and *Bass* cases is present here. . . . In the *Underwood* case,

> it was not decided that the entire net profits of the total business were to be allocated to Connecticut because that was the place of manufacture, or, in the *Bass* case, that the entire net profits were to be allocated to New York because that was the place where sales were made. In both instances, a method of apportionment was involved which, as was said in the *Underwood* case, "for all that appears in the record, reached, and was meant to reach, only the profits earned within the State." The difficulty with the evidence offered in the *Underwood* case was that it failed to establish that the amount of net income with which the corporation was charged in Connecticut under the method adopted was not reasonably attributable to the processes conducted within the borders of that State; and in the *Bass* case the court found a similar defect in proof with respect to the transactions in New York. [283 U. S. at 132-33.]

As was the case in *Underwood* and *Bass*, and in contrast to the showing made in *Hans Rees*, Moorman has made no effort to identify the precise source of its profits, and there is nothing in the record to justify a finding that the apportionment actually made to Iowa was unreasonable. Under such circumstances, as the Court made clear in *Hans Rees*, "in light of the difficulty of making an exact apportionment," an apportionment formula "will be sustained until proof is offered of an unreasonable and arbitrary application in particular cases." 283 U. S. at 133.

Since its decision in the *Hans Rees* case, the Court has on three occasions considered constitutional challenges to the application of a State's apportionment formula to a taxpayer's net income. In each instance the Court has rejected the challenge, and has reaffirmed the basic principles established in *Underwood*, *Bass*, and *Hans Rees*. In *Kent-Coffey Mfg. Co.* v. *Maxwell*, 291 U. S. 642 (1934), *aff'g per curiam* 204 N. C. 365, 168 S. E. 397 (1933), the Court upheld over Due Process Clause and Commerce Clause objections the application of North Carolina's single-factor property formula to the taxpayer's net income. The taxpayer had complained that the apportionment of over 99% of its net income to North Carolina was impermissible in light of

the fact that less than 1% of its sales were made in the State. The Court's affirmance on the ground that the case was controlled by *Underwood* rather than *Hans Rees*, 291 U. S. at 642, was no doubt based on the failure of the taxpayer to show the precise source of its net income—as Moorman here has failed to do—so as to demonstrate the alleged unreasonableness of the formula's application.

In still another case arising out of North Carolina, the Court sustained against constitutional attack the application of a single-factor mileage formula in the calculation of a railroad's net income apportionable to North Carolina, *Norfolk & Western Ry.* v. *North Carolina* ex rel. *Maxwell*, 297 U. S. 682 (1936). Rejecting the usual arguments by the taxpayer of gross overreaching by the State—including a contention supported by evidence that operating costs were higher than average in North Carolina—the Court noted: "For all that appears in the case developed by the Railway, actual gross revenues in North Carolina may have been so far in excess of average gross revenues computed under the statute as to neutralize the discrepancy between actual and average costs of operation." 297 U. S. at 686. Once again the Court emphasized that: "A finding that the statute . . . is oppressive toward the railway in its practical operation cannot rest upon so fragmentary and partial showing of facts. We must bear in mind steadily that the burden is on the taxpayer to make oppression manifest by clear and cogent evidence." *Id.* at 688.

The Court's most recent opinion addressing the constitutional issues raised by a challenge to the application of a net income apportionment formula is *Butler Bros.* v. *McColgan*, 315 U. S. 501 (1942). Following established principles, the Court once again upheld the application of the State's apportionment formula, based on property, payroll, and sales, to the taxpayer's overall net income, over the vehement objection that the operations in the taxing State were actually being conducted at a loss. To this the Court responded with the now familiar refrain: "The

fact of the matter is that appellant has not shown the precise sources of its net income of $1,149,677. If factors which are responsible for that net income are present in other States but not present in California they have not been revealed. At least in absence of that proof, California was justified in assuming that the San Francisco branch contributed its aliquot share to the advantages of centralized management of this unitary enterprise and to the net income earned." 315 U. S. at 509.

Three basic principles thus emerge from this Court opinions that have considered constitutional challenges to the application of state apportionment formulas to a taxpayer's net income. First, it is impossible to identify on an *a priori* basis the precise sources of net income derived from a unitary business engaged in manufacturing and selling—as was Underwood and Bass, and as is Moorman. Second, in light of the first principle, the States are given the utmost leeway both in their choice and application of formulas for apportioning the net income of unitary businesses carried on partly within their borders. Third, a taxpayer challenging the application of such a formula on constitutional grounds bears the heavy burden of demonstrating by clear and cogent evidence the precise sources of its net income to establish that the result achieved through the formula is in fact grossly distorted. In view of these principles, it is apparent that Moorman has not made out a sufficient case for overturning on constitutional grounds, the application of Iowa's single-factor sales formula to its net income.[5]

Moorman, while paying little more than lip service to the decisions discussed above, places its principal reliance instead upon this Court's decision in *General Motors Corp.* v. *District of Columbia*, 380 U. S. 553 (1965). Moorman's reliance is plainly misplaced, as indicated above (see pp. 20-22, *supra*).

5. While the critical defect in Moorman's case is evidentiary, it might also be noted that in four out of five of the cases in which the Court sustained net income apportionments, a single-factor formula was at issue, and in several cases, the allegations of unreasonableness were far more extreme than those made here.

Moreover, in light of the fact that it is only in the application of a formula to the net income of a particular taxpayer that an evaluation of its constitutionality can properly be made, it would be of little moment here even if the Court in the *General Motors* case had struck down the application of the District of Columbia sales factor formula to General Motors on constitutional grounds. For that would no more establish the unconstitutionality of Iowa's sales formula as applied to Moorman than the decision in *Hans Rees*, finding North Carolina's property formula unconstitutional as applied to one taxpayer, determined the result in *Kent-Coffey*, finding constitutional the application of the same formula to another taxpayer. See pp. 30-31, *supra*.

B. The Iowa Formula for Apportioning Net Income to the State Is Constitutional as Applied to Moorman Under the Commerce Clause.

The standards for determining the constitutionality of an apportionment formula's application under the Commerce Clause are substantially the same as those considered in connection with the Due Process Clause. See, *e.g.*, *Norfolk & Western Ry.* v. *State Tax Commission*, *supra;* see, also, pp. 10-11, *supra*. Indeed, as noted above, virtually all the cases discussed in the previous section involved challenges on both Due Process and Commerce Clause grounds and there is nothing in those cases to suggest that the Clauses have different implications in this context. It is, therefore, apparent that what has been said in discussion of Due Process is equally applicable here. To avoid repetition, only those additional matters relating to the Commerce Clause will be addressed here.

First, as suggested earlier, there is serious question whether the Commerce Clause may be relied upon at all as a basis for invalidating the Iowa tax as applied to Moorman. According to the stipulated facts, Moorman's products were manufactured in Illinois and shipped to Moorman's warehouses in Iowa. (App. 24.) Sales in Iowa were made by Iowa salesmen and warehouse-

men from Moorman's Iowa warehouses to Iowa customers. (App. 24.) These are not interstate sales; there is no interstate commerce affected by imposition of this tax. The fact that Moorman is a foreign corporation does not translate the tax into a burden on interstate commerce. The fact that, before the goods came to rest in Iowa warehouses, they made the journey from Illinois, does not make the Iowa sales into sales in interstate commerce. Hence, so far as Moorman is concerned, the tax in question here may be regarded as a tax on intrastate commerce only, with the measure of the tax a proportionate share of its net income.

Even assuming that the Commerce Clause does apply to Moorman's activities, however, it is apparent that Moorman's contentions on this score falter for the same reasons they fail with respect to the Due Process Clause. Moorman again misconceives the operation of the Iowa apportionment formula as applied to its net income. Thus Moorman refers to the amount of its federal taxable income apportionable to Iowa ($1,548,284 or approximately 22% of its apportionable income) as "[t]he total income derived from the manufacture and sale of goods to Iowa customers." (Appellant's Br. 11-12.) But the simple truth is that there is nothing in the record to support that statement because the record does not reveal the precise sources of Moorman's net income on a functional or geographical basis. It reveals only Moorman's overall federally-based net income to which the apportionment formula applies. See page 24, note 3, *supra*. Thus, application of the Iowa formula to Moorman's apportionable federal income does not, as Moorman suggests, determine Moorman's actual "net income resulting from the manufacture and sale of its products to Iowa customers." (Appellant's Br. 11.) Rather, it determines that portion of Moorman's overall net income that is being apportioned to Iowa on the basis of its sales in Iowa; for all that the record shows, the net income Moorman actually derived from its activities in Iowa would have been much higher if the sources of Moorman's net

income could have been precisely identified. It is Moorman's failure to identify these precise sources and to show by clear and cogent evidence that the apportionment made was grossly out of line with the sources so identified which requires that the apportionment be upheld in this case.

Moorman's speculative observations on the possibility of multiple taxation add little to its argument. Indeed, its hypothetical illustrations dramatize its failure to point to any evidence in the record that by taxing some 22% of its apportionable income, Iowa has in fact assigned to itself a disproportionate share of Moorman's profits. Moreover, it is plain that the Court will not strike down as unconstitutional one State's apportionment formula merely because another State's apportionment has been conceived on a different basis. See Point V, *infra*. "Unless a palpably disproportionate result comes from an apportionment, a result that makes it patent that the tax is levied upon interstate commerce . . . this court has not been willing to nullify honest state efforts to make apportionments." *International Harvester Co.* v. *Evatt*, 329 U. S. 416, 422-23 (1947). More recently the Court has pointed out that the constitutionality of one State's statutes cannot depend upon the present configuration of the statutes of another State. *Austin* v. *New Hampshire*, 420 U.S. 656, 668 (1975).

Moorman is likewise in error in suggesting that the mere "risk" of multiple taxation rather than actual proof of multiple taxation is the test for evaluating the constitutionality of an apportionment formula's application under the Commerce Clause. (Appellant's Br. 13.) In *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U. S. 450, 463 (1959), the Court flatly stated, after noting that "[t]here is nothing to show that multiple taxation is present," that "[w]e cannot deal in abstractions. In this type of case the taxpayers must show that the formula places a burden upon interstate commerce in a constitutional sense." Moorman seeks to find support for its position in such cases as *J. D. Adams Mfg. Co.* v. *Storen*, 304 U. S. 307

(1938), and *Evco* v. *Jones*, 409 U. S. 91 (1972), that refer to the "risk" of multiple taxation as the appropriate criterion. (Appellant's Br. 13.) But Moorman fails to note the critical distinction between the types of taxes involved. In *J. D. Adams* and *Evco* the Court was dealing with unapportioned gross receipts taxes, where the inherent risk of multiple taxation is self-evident. Here, as in *Northwestern*, we are dealing with an apportioned net income tax, where the risk of multiple taxation is small, and to the extent that it does exist, must be demonstrated by the taxpayer under the same exacting standards that are applicable to all constitutional challenges to state apportionment formulas.

Furthermore, Moorman's heavy reliance on *General Motors Corp.* v. *District of Columbia*, *supra*, is as misplaced in the Commerce Clause context as it was in the context of the Due Process Clause. See p. 32, *supra*. This Court's general observations about the possibility of multiple taxation can hardly be regarded as constitutional doctrine in light of its comments regarding the limited scope of its decision. Moreover, nothing in *General Motors* undermines the basic principle that it is only in light of the particular application of an apportionment formula to the net income of a taxpayer that its constitutionality can properly be evaluated. In view of that principle, the *General Motors* dictum can hardly affect the result here, which is required not only by the controlling constitutional standards but also by the insufficiency of Moorman's evidentiary showing.

In short, Moorman has failed to discharge the heavy burden that the guiding constitutional principles impose upon it of demonstrating by clear and cogent evidence that the application of Iowa's apportionment formula produced a grossly distorted result. As Judge McCormick, concurring in the Iowa Supreme Court's decision, succinctly put it:

> In the present case, Moorman did not attempt to prove the amount of its actual net income from Iowa activities in the years involved. Therefore no basis was presented for

> comparison of the corporation's Iowa income and the income apportioned to Iowa under the formula. In this era of sophisticated accounting techniques, it should not be impossible for a unitary corporation to prove its actual income from activities in a particular state. However, Moorman showed only that its tax liability would be substantially less if Iowa employed a three-factor apportionment formula. We have no basis to assume that the three-factor formula produced a result equivalent to the corporation's actual income from Iowa activities. Having failed to establish a basis for comparison of its actual income in Iowa with the income apportioned to Iowa under the single-factor formula, Moorman did not demonstrate that the single-factor formula produced a grossly unfair result. Thus it did not prove unconstitutionality of the formula as applied. [254 N. W. 2d at 757.]

III.

THIS COURT CANNOT INVALIDATE THE APPLICATION OF IOWA'S APPORTIONMENT FORMULA WITHOUT EFFECTIVELY OVERRULING ITS OWN LEADING PRECEDENTS IN THE STATE TAX FIELD AND SERIOUSLY DISRUPTING THE EXISTING FRAMEWORK FOR CONSTITUTIONAL ADJUDICATION IN THIS AREA.

It is appropriate to observe that disposition of this appeal has serious implications for the existing framework of constitutional adjudication in the State tax field far beyond the context of State apportionment formulas. This Court, out of a proper respect for State taxing authority, has rejected Due Process and Commerce Clause objections to exercises of State tax power far more extensive than are even alleged in this case. Thus, in *General Motors Corp.* v. *Washington*, 377 U. S. 436 (1964), and more recently in *Standard Pressed Steel Co.* v. *Department of Revenue*, 419 U. S. 560 (1975), the Court upheld taxes on the unapportioned gross receipts of taxpayers who, like Moorman, manufactured outside the taxing State all their goods sold in the taxing State. In *General Motors*, the State of Washington imposed its tax on the unapportioned gross receipts from GM's sales of motor

vehicles, parts and accessories delivered in the State. All of these articles were manufactured outside the State of Washington. 377 U. S. at 442. In *Standard Pressed Steel*, the State of Washington imposed its tax on the unapportioned gross receipts from Standard's sales of aerospace fasteners to its Washington customers. All of these articles were manufactured outside the State of Washington. 419 U. S. at 561. Indeed, in *Standard Pressed Steel*, the only in-state activities of the taxpayer were the presence of a single in-state employee and the occasional visits of its nonresident engineers—far less than Moorman's extensive activities in the State of Iowa. Yet the Supreme Court dismissed the Due Process objection as "frivolous," 419 U. S. at 562, and had little difficulty disposing of the Commerce Clause claim. *Id.* at 562-63. While one might attempt to distinguish the Washington cases from the instant case on the grounds that the tax there involved a "privilege" tax measured by gross receipts (rather than a net income tax), this Court just last Term made it perfectly clear that such labels had no role to play in the proper analysis of the constitutional limitations on State taxation. *Complete Auto Transit, Inc.* v. *Brady*, 430 U. S. 274 (1977). Thus, the invalidation of the Iowa tax in this case cannot be accomplished without effectively overruling the *General Motors* and *Standard Pressed Steel* cases, and the precedents on which they relied.

Moreover, if, as the Washington cases clearly indicate, the imposition of an unapportioned gross receipts tax on Moorman's sales in Iowa would violate neither the Due Process nor Commerce Clauses, it is difficult to imagine how Iowa's apportioned net income tax, apportioned by those same sales, could do so. For, as this Court has pointed out, the former poses a far greater threat to interstate business than the latter since "tax on gross receipts affects each transaction in proportion to its magnitude and irrespective of whether it is profitable or otherwise . . . and may be sufficient to make the difference between profit and loss," whereas a tax on net income, as is here at issue, "does not arise

at all unless a gain is shown over and above expenses and losses, and . . . cannot be heavy unless the profits are large." *United States Glue Co.* v. *Town of Oak Creek*, 247 U. S. 321 (1918). In short, if this Court were to strike down Iowa's apportioned net income tax in this case, it would *a fortiori* be effectively overruling numerous precedents upholding unapportioned gross receipts taxes on interstate businesses. See, *e.g.*, in addition to Washington cases discussed above, *International Harvester* v. *Department of Treasury*, 322 U. S. 340 (1944); *Allied Mills Inc.* v. *Department of Treasury*, 318 U. S. 740, *aff'g per curiam* 220 Ind. 340, 42 N. E. 2d 34 (1942); *American Manufacturing Co.* v. *St. Louis*, 250 U. S. 459 (1919). The result would be seriously and unjustifiably to disrupt the existing framework for constitutional adjudication in this complex area.

IV.

THE STATUTORY REQUIREMENT THAT NET INCOME BE APPORTIONED TO IOWA BY THE RATIO OF IOWA SALES TO TOTAL SALES IS CONSTITUTIONAL ON ITS FACE AND AS APPLIED TO MOORMAN UNDER THE EQUAL PROTECTION CLAUSE.

As the Iowa Supreme Court recognized, 254 N. W. 2d at 752-54 (App. 134-39), Moorman's objections to the apportionment provisions of the Iowa corporate income tax statute on Equal Protection grounds are insubstantial. Whatever classifications the statute makes (or can be deemed to make) are plainly within the wide bounds of discretion accorded State legislatures under the Equal Protection Clause:

> [The Equal Protection Clause] imposes no iron rule of equality, prohibiting the flexibility and variety that are appropriate to reasonable schemes of state taxation. The State may impose different specific taxes upon different trades and professions and may vary the rate of excise upon various products. It is not required to resort to close distinctions or to maintain a precise, scientific uniformity with reference to composition use or value. . . .

> Similarly, it has long been settled that a classification, though discriminatory, is not arbitrary nor violative of the Equal Protection Clause of the Fourteenth Amendment if any state of facts reasonably can be conceived that would sustain it. . . . [*Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U. S. 522, 526-28 (1959).]

See also *Lehnhausen* v. *Lake Shore Auto Parts Co.*, 410 U. S. 356 (1973).

In light of these principles, it is apparent that Moorman's Equal Protection arguments may be disposed of summarily. For even if the statute were deemed to make a distinction between various types of businesses being carried on in Iowa—or even similar businesses being carried on in different ways—the State legislature may rationally regard such differences as significant and is therefore free to treat them differently under its taxing schemes. If any further support is needed for this conclusion, *Kahn* v. *Shevin*, 416 U. S. 351 (1974), surely provides it. The issue there was whether a Florida tax statute providing an annual $500 property tax exemption for widows without providing any comparable exemption for widowers offended the Equal Protection Clause. The Court was thus faced not merely with a classification made between types of businesses —as in the cases cited above (and arguably in the instant case)—where the Court has always granted the States considerable leeway. Rather, it was faced with the distinction made between individuals on the basis of gender, which the Court has viewed under much stricter standards of equality. See, *e.g.*, *Frontiero* v. *Richardson*, 411 U. S. 677 (1973); *Reed* v. *Reed*, 404 U. S. 71 (1971). Nevertheless, the Court rejected the challenge and upheld the statute relying on *Allied Stores* and *Lehnhausen*, and it reaffirmed the principle that where State taxation is concerned, the States are afforded the utmost freedom in drawing lines which in their judgment produce reasonable systems of taxation. That test is clearly met in this case.

V.

FOR THIS COURT TO HOLD THE IOWA APPORTIONMENT FORMULA UNCONSTITUTIONAL WOULD IN EFFECT IMPOSE A UNIFORM FORMULA UPON THE STATES, THUS IMPROPERLY ARROGATING TO THE COURT A FUNCTION ONLY CONGRESS IS CONSTITUTIONALLY ENTITLED TO PERFORM.

The Commerce Clause is an affirmative grant of power to Congress "[t]o regulate commerce . . . among the several States." U. S. Const., art. I, § 8, cl. 2. There is no question that this power is broad enough to support the enactment by Congress of legislation requiring the States to use a particular apportionment formula in taxing income derived from interstate commerce. It is equally clear, however, that this Court has no such power to act affirmatively in performing its limited constitutional function of construing the restrictions imposed on State tax power by the Commerce Clause. Rather it is confined "to the negative approach resulting from a case-by-case resolution of 'the extremely limited restrictions that the Constitution places upon the states. . . .,' *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435 (1940)." *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U. S. 450, 457 (1959). As Mr. Justice Frankfurter put it in his opinion dissenting from the result:

> At best, this Court can only act negatively; it can determine whether a specific state tax is imposed in violation of the Commerce Clause. Such decisions must necessarily depend on the application of rough and ready legal concepts. We cannot make a detailed inquiry into the incidence of diverse economic burdens in order to determine the extent to which such burdens conflict with the necessities of national economic life. Neither can we devise appropriate standards for dividing up national revenue on the basis of more or less abstract principles of constitutional law, which cannot be responsive to the subtleties of the interrelated economies of Nation and State. [*Id.* at 476 (dissenting opinion).]

If this Court were to strike down the Iowa apportionment formula as unconstitutional, it would in effect be prescribing a uniform formula for all the States in plain violation of these principles. For it is only by assuming that the three-factor formula employed by Illinois is the sole appropriate constitutional method for dividing a taxpayer's net income that Iowa's single-factor formula can be deemed to raise any question of unfairness. It is indisputable that if all jurisdictions apportioned net income the way Iowa does, no enterprise would be heard to complain about multiple burdens, overreaching, or the like. It is only because Iowa has chosen to apportion net income in a manner that differs from that employed by Illinois that the issue of unfair apportionment under the Commerce Clause has been raised. But, unless the Court chooses in effect to endorse the Illinois formula rather than the Iowa formula as the single controlling constitutionally acceptable standard, there is no basis for finding that whatever unfairness may allegedly result from the use of two different formulas is the "fault" of Iowa rather than Illinois, to use Moorman's language. (Appellant's Br. 8.) In short, the assumption that would necessarily underlie any determination by this Court that the Iowa apportionment formula was unconstitutional—*i.e.*, that the Illinois three-factor formula is the sole constitutionally acceptable formula—cannot be made consistently with this Court's limited role under the Constitution in acting "negatively" to determine, on a case-by-case basis, whether a particular State levy has transgressed the "extremely limited restrictions that the Constitution places upon the states." *Wisconsin* v. *J. C. Penney*, 311 U. S. 435, 445 (1940), quoted in *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U. S. 450, 457 (1959).

The lack of power in this Court to prescribe a uniform apportionment formula for the States does not depend, of course, on whether Congress has itself considered whether to exercise its affirmative power under the Commerce Clause by imposing a uniform standard. Nevertheless, the fact that Congress has on numerous occasions contemplated the possibility of legislating

in this area and has repeatedly chosen not to do so[1] would make any such action by the Court in this area especially inappropriate. In light of Congress' deliberate decision not to impose a uniform apportionment formula upon the States in an area in which it alone has the constitutional power to act affirmatively, any action by this Court effectively imposing such a uniform standard upon the States would be doubly offensive: it would exceed the power confided to it under the Constitution and would do so contrary to the expressed intent of that branch of government to which such matters are in fact confided.

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1. Congressional hearings on proposed legislation were held in 1966, *Hearings on H. R. 11798 Before the Special Subcomm. on State Taxation of Interstate Commerce of the House Comm. on the Judiciary*, 89th Cong. 2d Sess. (1966), and in 1973, *Hearings Before the Subcom. on State Taxation of Interstate Commerce of the Senate Finance Comm.*, 93d Cong., 1st Sess. (1973). Bills were passed by the House in 1968, H. R. 2158, 90th Cong., 2d Sess. (1968), see 111 CONG. REC. 14,432-33 (1968), and in 1969, H. R. 7906, 91st Cong., 1st Sess. (1969), see 115 CONG. REC. 17,323 (1969), only to die in the Senate. And legislation in this area has been introduced in Congress in virtually every session for the last decade. *See* Glasser, *Proposed Solutions to Areas of Conflict in Taxation of Interstate Business*, in 1 33rd ANN. N. Y. U. INST. ON FED. TAXATION 983 (1975); New York State Bar Ass'n Tax Section, Committee on Interstate Taxation, *Proposals for Improvement of Interstate Taxation Bills*, 25 TAX LAWYER 433 (1972); New York State Bar Ass'n Tax Section, Committee on Interstate Taxation, *Supplemental Proposals for Improvement of Interstate Taxation Bills*, 27 TAX LAWYER 213 (1974).

CONCLUSION.

For the reasons spelled out above, the judgment of the Supreme Court of Iowa should be affirmed.

Respectfully submitted,

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